

**October 30, 2007**

**Honorable Council President Spencer, City Council and Citizens of Reading:**

In accordance with the City Charter, I submit to the City Council an annual operating budget for the City of Reading for the fiscal year beginning January 1, 2007 and ending December 31, 2007 (FY 2007).

This budget, as it predecessors, reflects the stark realities of local government in Pennsylvania. Much progress has been made in our strategic priorities, yet we are still early in the process relative to where we need to be. Progress continues to be made in neighborhoods, financial performance, and economic development; and my expectations are high for more positive results. Our war on crime continues with mixed results. Murders are down compared to a year ago, some indicators show good progress, but perceptions have not changed much regarding safety in the city. The 2007 Proposed Budget describes Reading's continued financial challenges and lays out a strategy that will permanently sustain the city.

The theme of hard decisions continues in the Proposed 2007 Budget, but our options diminish over time. This is going to harder than ever since I am proposing some increases in taxes, stable expenditures when compared to 2006, and proposals for further restructuring of this government. The size of the City of Reading organization is near its optimal level when balancing our service delivery needs and citizens' willingness and ability to pay. We recognize that our citizens deserve the highest quality service that we can provide within a realistic budget. Compromises will have to be made in this decision process. But we are confident that with the support of city council and the citizens of Reading, we can achieve the goals in our core values:

- 1) **Sustain and advance our goals in public safety.** The City needs to continue developing effective strategies for crime reduction and improvement of quality of life of our citizens. The principal strategies in this area are based on the deployment of more manpower and appropriate technologies on Reading streets.
- 2) **Retain and create family-supporting jobs for our citizens.** This priority can be achieved through coordinated economic development efforts working with city,

county, state and federal organizations. This includes downtown development along with aggressive marketing of our city to bring in responsible businesses.

- 3) **Engage our citizens in neighborhood rebuilding.** This priority is furthered through increased code enforcement, building neighborhood organizations and coordinating sustainable housing programs. The City's budget along with the 2007 Community Development Block Grant Action Plan enables these efforts to continue.
- 4) **Achieve financial stability.** The City needs to continue being on the forefront of designing systems to make government operate more efficiently, obtaining the technology and tools to help city workers do their jobs efficiently, and carefully examine the business that the city should be in and not be in so that we can do everything possible to avert becoming a distressed city.

We have made substantial progress on the final goal, and I am the most optimistic since 2004. Labor and associated costs such as pension continue to create financial stress on the City, but the employees of this organization are also the people who will lead us to better results. The City of Reading continued its restructuring efforts in 2006 by re-engineering all financial operations, proposed restructuring of the Police Department through collective bargaining (results are unavailable at this time), and even proposing enhancement such as a customer call center. A major piece of making the Proposed 2007 Budget reasonable is the issuance of Pension Bonds that fully fund all three funds and lower the City's minimum obligation by \$2.4 million annually. However, these efforts will not be sufficient to address a structural deficit that continues to plague the City, thus necessitating various tax increases.

The basis for this budget will take the full commitment of all our elected representatives at the local, state and federal level. It will also take persistence once we commit to a real community and financial turnaround in Reading. Some goals may take many years to reach and overcome seemingly impossible obstacles when encountered. This budget, like all such plans, provides a blueprint for real sustainability and allows us to dismiss Act 47 as an option.

This budget contains estimates of revenues and expenditures for both the current and upcoming fiscal years. Detailed breakdowns of expenditures by program are included in each departmental section.

The Proposed Fiscal Year 2006 General Fund Budget is summarized as follows:

|                    | <b>FY 2006 Budget</b> | <b>FY 2007 Budget</b> | <b>Change</b> | <b>%<br/>Change</b> |
|--------------------|-----------------------|-----------------------|---------------|---------------------|
| Personnel Expenses | \$45,375,884          | \$46,773,562          | \$1,397,678   | 3.08%               |
| Operating Expenses | \$7,697,901           | \$11,769,486          | \$4,071,585   | 52.89%              |

|               |                     |                     |                    |              |
|---------------|---------------------|---------------------|--------------------|--------------|
| Debt Service  | \$4,552,086         | \$4,488,443         | (\$63,643)         | (1.40%)      |
| Transfers Out | \$1,579,336         | \$1,763,632         | \$184,296          | 11.67%       |
| <b>Total</b>  | <b>\$59,205,207</b> | <b>\$64,795,123</b> | <b>\$5,589,916</b> | <b>9.44%</b> |

The General Fund has direct impact on the tax burden for Reading citizens and businesses. The cost of city operations is proposed to be higher in 2007 by \$5.6 million. This is a similar trend found in 2006 where total expenditures increased by 8.7 percent. Labor and pension costs are driving expenditure requirements beyond the City's ability to pay. Most of this impact is our own doing by securing collective bargaining agreements with all groups, pending the outcome of the Fraternal Order of Police approval process. Perhaps it was fashionable to think public employees would forego pay raises for a few years, but we need to acknowledge that employees, particularly public safety employees need to be compensated at an equitable and appropriate manner. Escalating pension costs are another example of an item that is proposed to be more predictable through a pension bond issuance in the fall of 2006. Significant expenditures increases for operating expenses are driven by the following factors for FY 2007:

- Bringing expenditures historically funded in the Liquid Fuels Fund to the General Fund -- \$780,000
- Utilities -- \$750,000
- Gasoline -- \$250,000
- Curb cuts and handicap ramps in rights of way -- \$150,000
- Vehicles -- \$560,000
- Expenses for the Office of Neighborhood Development and Citizen Call Center -- \$65,000
- Shifting retiree health insurance costs from personnel to operating expenses -- \$1,784,988

The last item, along with the reduced pension costs for City employees, allows the personnel expenses category to increase a modest 3 percent for 2007.

Changes in various expenditures demonstrate how vulnerable the city is to the same experiences of many others. For example, prices for petroleum products and natural gas are projected to increase from current levels as the winter season approaches. But, for the first time since the winter of 2001-02, residential heating fuel prices for most Americans are projected to be either lower than or close to prices experienced last year, according to the U.S. Department of Energy. I believe the city should be responsive wherever possible, and that is why I proposed and the City Council approved the creation of a Customer Call Center. It will be modest by national standards, but it

should provide extraordinary responsiveness compared to many citizens' current experience.

### *Fiscal Year 2006 Update*

The approved General Fund budget for fiscal year FY 2006 is \$59,205,207. The City has not been in cost containment mode this year, but operates in a conservative fashion resulting from prior reductions. The City currently enjoys revenues consistent with budgeted amounts with the exception of real estate transfer tax revenue, which are projected to exceed estimates by \$2.5 million. This projection is fortunate because it large supplants the City's dependence on one-time revenues of \$2.7 million budgeted in 2006, but were realized in 2005. Operational expenditures in 2006 are within budgeted amounts, but challenges remain in legal services and energy costs where their expenditures are estimated to exceed budgets by a collective \$300,000.

For the 2005 budget, the City experienced revenues that surpassed a \$54.5 million budget. The City has taken several steps to mitigate this shortfall in the form of tax swaps (\$650,000), real estate sales (\$500,000), and debt restructuring (\$1.4 million) in 2005. The City was also active in forward bond sales that produced \$3 million and obtaining approval from the City Council for the sale of Antietam-area property (\$4 million). The latter is still in litigation, but the prospects are positive that the City Council's actions will be affirmed.

Coupled with the planned pension bond which is expected to create \$6.5 million in savings in 2006, and additional interest rate swaps estimated at \$6 million, the City reasonably expects to have a substantial General Fund Balance for the first time in several years. However, these transactions and similar work the last three years have only put the City on better financial footing. The remaining challenge is to get revenues to meet expenditures on an annual and routine basis.

### *National and State Economy*

The economic outlook shows optimism amongst business owners has receded from the record levels reported this past spring. Business owners have moved on from last year's guarded optimism to hiring on a regular basis. Steady employment is projected for Pennsylvania although it lags behind the national rate. The job growth is broad-based, but is dogged by declines in manufacturing and retail trade. Pennsylvania will continue to enjoy strong housing demand mostly fueled by spiraling costs in neighboring states. New York, New Jersey, and Maryland are experiencing increases in housing prices beyond the capability of many, who now buy in Pennsylvania and take on grueling commutes. Rising energy prices and the likelihood of further increases in interest rates are adding to cost pressures and appear to be the only threats to the housing surge in the region. In light of these rising costs, 46 percent of business owners

plan to raise prices.<sup>1</sup> Personal income growth is steady, but is barely keeping up with inflation, which hurts the City's earned income tax outlook.

Business activity is also expected to grow at a modest pace. Manufacturers expect improvement but do not anticipate strong gains. Retailers forecast a modest growth in sales (despite employment losses); however, auto dealers do not expect sales to pick up. Bankers expect a further decline in mortgage lending and slight gains in business and consumer lending. Service-sector firms expect business to continue to move up slowly.<sup>2</sup>

Pennsylvania's economy remains in the midst of a steady expansion. Data suggest the state is on course for its most rapid pace of job growth since 2000. More encouragingly, job gains have been spread across most major industry groups; implying broad-based growth has taken hold. One notable exception is manufacturing, which continues to shed jobs, albeit at a slower pace than has been the case in recent years.

Household credit conditions in the state have continued to weaken thus far in 2006. Mortgage delinquencies and personal bankruptcy filings have slowed and are only threatened by the prospect of higher interest rate. Improved job and income growth will help stem further erosion in household balance sheets in 2007, but rising interest rates will mean heavier debt burdens for those households locked into variable rate debt.

## **FY 2005 BUDGET PREPARATION PROCESS**

The Budget Review Team met with the Department Directors/staff and reviewed the preliminary budget. After careful analysis and discussion with administrative staff, additions and deletions were made. The leadership of all city departments also met with the City Council's Finance Committee in September and early October. The budget was then presented to the Mayor for review and approval.

Budget discussions also began in June with policy discussions between the City Council and the Administration. Additional research was conducted through surveying in July. Budget priorities were further refined in October to further define the City priorities and tolerances for service reductions and revenue increases.

### ***Revenues***

Revenues continue to be sluggish in 2006, with the exception of the real estate transfer tax, and will be similarly reflected in 2007. Revenues are projected to be higher in 2007 compared to 2006 by \$4,514,380. However, this increase comes at high price. A property

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<sup>1</sup> **Stuart G. Hoffman**, Senior Vice President and Chief Economics, *PNC Bank*, Economics Division, The PNC Financial Services Group, Inc., Pittsburgh, PA

<sup>2</sup> **Governor Donald L. Kohn**, *U.S. Federal Reserve*, 2006 Global Economic and Investment Outlook Conference, Carnegie-Mellon University, Pittsburgh, Pennsylvania

tax increase is proposed for 2007 at the maximum amount allowed by the Reading City Charter. The city can increase property tax revenues by 5 percent (\$651,000) more than the previous year. This clause is particularly harmful in light of planned economic development projects expected in the near future. The City would not benefit from significant redevelopment projects if it has to implement tax cuts to keep revenues within the statutory cap. The proposed increase in the property taxes does not come without significant concerns regarding Reading citizens' ability to pay. However, I believe capacity exists for the City to increase these taxes for three reasons. One, this taxing source has not significantly changed since 1994 (with the small exception of a one-tenth increase this year for tree management).

An increase of 1.5 percent increase in the real estate transfer tax (to 5%) is also proposed for 2007 for a budgetary increase of \$4.3 million, and an actual increase of \$3 million. I fully understand this rate is likely one of the highest, if not the highest in Pennsylvania, but there are few choices and local real estate sales will remain strong in order for the city to reap the financial rewards.

In terms of General Fund Reserves for the 2006 budget, the basic structure of revenues was continued from prior years. Property tax rates are proposed to increase by .515 mills (or 5%) in the 2006 budget. This is the maximum amount allowed by the city charter and is the first property tax increase since 1994. The financial impact, normally estimated at \$742,000, is mitigated by more reasonable assumptions (88% collection rate and actual collections) described earlier.

Act 511 Taxes, which include the EIT increase of two-tenths (.2), are proposed to increase by \$6.3 million as a result of the rate increase and another increase to the real estate transfer tax described earlier. In the future, EIT revenue will also increase as incomes and employment in the city increase. It is the goal of the administration to aggressively pursue economic development, including job retention and job creation to raise the base of the income of city residents so they will be able to afford the level of service needed.

The major category of Intergovernmental Revenues is the pension contribution from the Commonwealth of Pennsylvania. These revenues are expected to remain stable for 2007 at around a budget amount of \$3.2 million. Pension costs are projected to slightly decrease in 2007 by \$70,000. These revenues are based on the number of full-time employees (units) where uniformed employees are allotted two units and non-uniformed employees have one unit. The value of a unit is determined on an annual basis based on insurance proceeds and number of units for municipalities in the Commonwealth.

Non-revenues (transfers from enterprise funds and the fund balance carry forward amount), continue to be a major factor in the General Fund Budget. The General Fund

receives \$3,910,000 as a financing fee and for indirect costs from the Water Authority, and it is proposed to increase to \$4 million in 2007. Therefore, the financial stability of the Authority is very important to the City, to ensure that the Authority can make legally obligated payments.

Conversely, the General Fund receives \$3.75 million from the Sewer Enterprise Fund for 2007, down another \$750,000 based on a consent decree. The City recently committed to a Consent Decree with the U.S. Department of Justice, which contains a commitment to reduce the dependence on Sewer Enterprise Fund transfers. The transfer will continue one more year until it reaches \$3 million in 2008. The City continues to be very dependent on non-revenues to maintain current levels of service, but not at the expense of neglecting its utility infrastructure. As service level demands increase, the City will need to continue relying on revenues from user fees and enterprise fund contributions.

The City expects to earn near \$6 million in real estate transfer tax revenues in 2006. There is risk in depending on this source, but the number of transactions is conservatively estimated based on the average number the last three years.

|                          | 2006      |                   | 2007      |                   | Difference          |
|--------------------------|-----------|-------------------|-----------|-------------------|---------------------|
|                          | Budget    |                   | Budget    |                   |                     |
| <i>Revenues</i>          |           |                   |           |                   |                     |
| Real Estate Taxes        | \$        | 15,397,180        | \$        | 15,350,873        | \$ (46,307)         |
| Act 511 Taxes            | \$        | 14,917,326        | \$        | 21,217,327        | \$ 6,300,001        |
| Licenses, Permits, Fines | \$        | 4,024,375         | \$        | 4,071,050         | \$ 46,675           |
| Intergovernmental        | \$        | 5,082,563         | \$        | 4,714,300         | \$ (368,263)        |
| Charges for Services     | \$        | 1,026,250         | \$        | 1,838,920         | \$ 812,670          |
| Interest and Rent        | \$        | 2,408,050         | \$        | 2,419,800         | \$ 11,750           |
| Emergency Medical Svcs*  | \$        | 2,293,300         | \$        | 2,599,850         | \$ 306,550          |
| Other                    | \$        | 2,713,949         | \$        | 4,328,033         | \$ 1,614,054        |
| Other Financing Sources  | \$        | 11,342,215        | \$        | 8,255,000         | \$ (3,087,215)      |
| <b>TOTAL REVENUES</b>    | <b>\$</b> | <b>59,205,207</b> | <b>\$</b> | <b>64,795,123</b> | <b>\$ 5,589,916</b> |

The proposed revenues for 2007 are necessary and attainable. Two, a measure of reasonableness can be argued to exist when we look at the impact on Reading taxpayers in relation to their income and property values. The Reading taxpayer with the median property value of \$40,000 would experience a \$75, or 4 percent, increase in total taxes to the city.

And three, we recently heard with great clarity citizens' willingness to fund police service at an adequate level. I proposed funding that delivers on that willingness as the

cost of current personnel rises and the RPD continues to re-deploy officers to field services responsibilities. The Reading Police Department will be one of the most efficient operations of its type in the nation as we re-allocate personnel to patrol duties. Chief Heim will reassign 10 personnel in January, 2007, and the collective bargaining agreement immediately allocates another 8 personnel if approved. The City has also successfully garnered State funding for another five positions that should be on Reading streets at the end of 2007.

### *Fiscal Year 2006 Operations*

The 2007 Budget proposes that the revenue increases define the amount of government the citizens of Reading can pay. The question then turns to what services can this amount afford to pay. There are several cues that provide insight. First, the Mayor's Priorities are:

1. Financial Stability
2. Public Safety
3. Strong Neighborhoods
4. Encourage Redevelopment

The Proposed 2007 Budget embodies financial stability. It includes revenue increases, expenditure reductions, and service restructurings that intend to deliver the results the public expects. No service reductions are proposed for 2007. The City is nearing the end of its ability to reduce and restructure itself, and our attention now turns to service shedding, most notably with Berks County.

President Spencer and I recently sent correspondence to Berks County for their consideration for additional Library funding for an estimated budget impact of \$425,000 in 2007. Other recommendations would augment or enhance services such as a juvenile curfew center, an environmental court, and parks management along the Schuylkill Riverfront.

Berks County continues to be a solid partner of the City of Reading. It was one year ago we both examined various operations as part of an Early Intervention Program sponsored by the Governor's Office. That process has already helped the city in fine-tuning our revenue projections for this budget, re-engineered financial services and laid the groundwork for the RPD's restructuring.

This budget is not without some carefully placed investments that are consistent with my priorities, and responsive to clearly identified needs of the community. This Budget proposes several policy initiatives that respond to Mayoral priorities.

Public Safety



- Addresses expenditures related to the re-deployment of uniformed officers such as civilian positions for vacated positions (\$150,000)
- Vehicle costs for more personnel on patrol (\$520,000)

#### Neighborhoods

- Bringing the Office of Neighborhood Development into the City organization (\$196,000).
- Adding the Work camp Project to the City's portfolio (\$30,000).
- Shifting streetlighting costs from the Liquid Fuels Fund to the General Fund which enables street maintenance and paving (\$750,000)
- Expanding the Midnight Ministries program (\$5,000).
- Networking with RISD and existing programs for an expanded mentoring effort at a negligible cost.

#### Economic and Community Development

- Create discretionary expenses for business recruitment and retention efforts at a cost of \$25,000.
- Positioning the city to be an active player in redevelopment efforts.

The City also makes a significant investment in customer service with the startup of a Citizen Call Center. The operation's funding needs are nearly \$200,000, which are evenly shared between the General, Solid Waste, Water, and Sewer Funds.

#### **Sewer Enterprise Fund**

The Sewer Enterprise Fund has an operating budget of \$23,178,813, a \$1.6 million increase over 2006. Expenditures for the Sewer Fund are principally driven by increases of sewage treatment, specifically utilities (\$100,000); contracted services (\$375,000); fees (\$200,000); and consulting services (\$240,000). This fund operates the City's sanitary sewer system and its wastewater treatment plant. The operations of the Fund are under the oversight of the Public Works Department. The revenues can be categorized into five basic sources:

|                                      |                |
|--------------------------------------|----------------|
| Consumers within the City of Reading | \$13,628,813   |
| Outside Municipalities               | 7,660,000      |
| Industrial Waste                     | 1,200,000      |
| Industrial Waste Testing             | 100,000        |
| Sewer Reservation Fees               | 350,000        |
| <u>Other</u>                         | <u>310,000</u> |
| Total                                | \$23,248,813   |

For the 2006 Budget, the Sewer Fund transfers \$3.75 million to the General Fund, which is \$750,000 less than the 2006 budget. As stated previously, the transfer will continue to decline one more year until it settles at \$3 million in 2008. Factors which are important

on the revenue side are flows within the outside municipalities, changes in the water rate and industrial waste pre-treatment by industries. The sewer system needs extensive capital improvements as prescribed in the Consent Decree, and will begin in 2007.

### **Solid Waste/Recycling Fund**

The Proposed 2007 Budget contains citywide trash collection for the city. A referendum challenging the City Council's decision for citywide trash is on November 7, 2006 that ultimately determines the scope of this basic municipal service. The proposed budget totals \$5.7 million for trash collection and recycling, which is \$2 million more than in 2006 and for approximately two-thirds coverage of the community. The vast majority of the fund's revenues (and contract expenditures) derive from user fees totaling \$5.3 million. Other revenues come from grants and certifications.

### **Liquid Fuels Fund**

Funding for the Liquid Fuels Fund is provided by revenues shared by the Commonwealth of PA totaling \$1,175,550, down \$43,384 in 2006. The City historically used this funding for street lighting and their maintenance, which are proposed to be shifted to the General Fund in 2007. These funds are now available for various street projects such as cleaning of streets, snow removal, paving of streets, and traffic engineering. Funding from the Liquid Fuels Fund is included with the programs of Streets and Traffic Engineering. In addition, the Liquid Fuels Fund provides the funding for all of the capital purchases in the Streets Program. The amount of this fund is set by the state of Pennsylvania according to population statistics and is not changeable.

### **Self Insurance Fund**

The Self Insurance Fund provides payments for the City's Property, Liability, and Worker's Compensation Insurance. The projected expenditures of \$2,342,314 represent an increase of \$620,481 from 2006, and similar to this year's increase of \$572,010. Most of the expenditure increase is in the worker's compensation area to more accurately reflect the city's experience. However, the city restructured its risk management program by creating a competitive environment and setting deductibles more attuned to Reading's profile. The City avoided a \$750,000 assessment in 2006 from the Commonwealth. The Self Insurance Fund receives income from its own investments and from damages recovered. The City will continue its strategy of resolving old claims and managing future risk.

### **Debt Service**

General Fund Debt Service for 2006 will be \$4,488,443, or \$63,643 less than in 2006,

because of the debt service restructuring completed in September 2005. Sewer debt service is paid directly out of that fund. The city should not see an increase in debt service over the next two years. The City repaid \$3.7 million in 2004 and an additional \$4.5 million in 2005 in principal and interest.

Debt service for the Sewer Fund will reduce in 2005 to approximately \$4.8 million. Outstanding principal in the Business Activity Funds are \$64.9 million. The City repaid \$5.3 million in 2004 and repaid an additional \$4.8 million in 2005 in principal and interest in the Sewer Fund.

## **CONCLUSION**

The Proposed FY 2007 Budget describes a city government that needs to continue reducing costs where possible while many costs sometimes referred to as fixed costs escalate at alarming levels. However, the city has to lower its costs through creative means such as debt service restructuring. This budget also proposes that the City not shy away from its priorities to create a safe community, strengthen neighborhoods, and encourage redevelopment. This budget also makes credible gains in the financial performance. I ask the City Council to continue putting the community's interests first, and show the willingness to make tough decisions that can periodically adversely affect citizens in their districts. You have already shaped this budget based on many of your suggestions being incorporated.

## **ACKNOWLEDGMENT**

The preparation of this budget on a timely basis could not be accomplished without the efficient and dedicated participation of the administrative staff. The budget process reflects a team effort among the Mayor's/Managing Director's and Finance offices and the City's operating departments. I would like to express special appreciation to Ryan Hottenstein, Finance Director; JoAnne Frantz, Confidential Secretary; Cindy Widel, Tax and Budget Manager, and Leon Churchill, Managing Director; for coordination of the budget preparation. I also thank all the City staff who prepared their respective sections of the budget. They are to be commended for their cooperation and assistance, and willingness to be part of Pennsylvania's best success story among its local governments.

Sincerely,

Thomas M. McMahon  
Mayor